Paper 7- Direct Taxation

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Full Marks:100 **Time allowed: 3 hours**

Section A : (80 Marks)
Income Tax

I. Answer question No. 1 which is compulsory and any FOUR from Question No. 2 to 7

1. (a) Fill up the blanks:

(i) Will

(ii) 20%

(iii) Nil

(iv) ₹1,00,000

(v) 16 years

(b) Choose the most appropriate alternative:

(i) (b)

(ii) (c)

(iii) (d)

(iv) (c)

(v) (b)

(c) Answer the following questions with brief reasons/Workings

(i) <u>Tax liability of insurance company</u>

Normal Tax @ 30.90% = ₹18,54,000

MAT u/s 115JB is not applicable

(ii) <u>Tax liability of AOP (growing and manufacturing of tea in India)</u>

Agricultural income @ 60% =	₹6,00,000
Non- agricultural income @ 40% =	₹4,00,000
Step I Tax on ₹10,00,000 = (2,50,000 × 10% + 5,00,000 × 20%)	₹1,25,000
Step II Tax on ₹8,50,000 = (2,50,000 × 10% + 3,50,000 × 20%)	₹95,000
Step III I – II =	30,000
Step IV cess @ 3% =	900
Step V Tax liability =	30,900

(iii) The above statements are incorrect. A foreign Co. will become resident in India if its place of effective management is situated in India. If its POEM is not situated in India it becomes a Non – resident in India u/s 6(3).

(iv) Gifts received from a company, whether having substantial interest or not is taxable under the head "Income from other sources" incase of individual or HUF if the aggregate amount of cash gifts during the year exceeds ₹50,000. In the given case, ₹3,00,000 is taxable u/s 56(2).

(v) If a person deposits cash of ₹10 lakhs or more in a year in any savings Bank Account, banking company is under obligation to furnish Annual Information reports u/s 285 BA. Such return is to be submitted to CIT within 31st of August of relevant Assessment year. In the given case, PNB should submit AIR.

2. (a) Computation of AOE u/s 14A

	₹
Expenditure related to exempted income	10,000
Common expenses not directly related to EI $\left[\frac{5,40,000 \times 10,00,000}{90,00,000}\right]$	60,000
Average investment 10,00,000 × 0.5%	5,000
Expenditure u/s 14A	75,000

Computation of total income

	₹
Business income	3,00,000
(+) disallowed expenses u/s 14A	75,000
PGBP	3,75,000

PGBP	3,75,000	
Share from PFAS	-	exempt u/s 10(24)
Interest on units	-	exempt u/s 10 (35)
GTI	3,75,000	
(-) Deductions		
Under chapter VIA	Nil	
NTI	3,75,000	

b) Computation of income from house property

Annual rent	=	1,20,000
(+) Non – refundable deposit $\left[\frac{5,00,000}{10}\right]$	=	50,000
GAV		1,70,000
(-) M. taxes		Nil
NAV		1,70,000
(-) S. D @ 30% u/s 24 (a)		51,000
		1,19,000
(+) Arrears of rent u/s 25B [20,000 – S. D @ 30%]		14,000
IHP		1,33,000

3. (a) Calculation of MAT u/s 115JB

	₹
Net profit as per P & L a/c	18,00,000
(+) Expenditure related to Expected income	50,000
(+) Income tax penalty	-
(-) Dividend income u/s 10 (34)	3,50,000
(-) unabsorbed deprecation or business loss	-
Book Profits	15,00,000

MAT u/s 115JB @ 19.055% = 2,85,830 [Ro u/s 288B]

(b) Determination of residential States for AY 2015 - 2016

Financial	Number of days in India
2009 – 10	100
2010 – 11	100
2011 – 12	100
2012 – 13	100
2013 – 14	100
2014 – 15	100

Basic conditions u/s 6(1)

(a) Stay in India for (182 days or more during the relevant previous year – not satisfied
Or
(b) Stay in India for 60 days or more during the relevant previous year – satisfied (100 days)
and
Stay in India for 365 days or more during the four years preceding the previous year – satisfied (400 days)

Conclusion: Since he satisfy the second condition, he become resident for the AY 2015 – 16

Additional conditions u/s 6 (6)

(i) Resident for at least two years out of ten years preceding the previous year – not satisfied (resident for only year)
and
(ii) Stay in India for 730 days or more during the seven years preceding the previous year – not satisfied (500 days)

Conclusion: Since he does not satisfy additional conditions, he become not ordinarily resident

4. (a) Computation of PGBP

	₹
Net profit as per P & L A/c	9,25,000
(+) Payment in cash u/s 40A (3)	60,000
(+) Depreciation @ 15%	60,000
(-) Deprecation @ 7.5% (half)	30,000
(-) Additional depreciation @ 10% (half)	40,000
Business Income	9,75,000

Note: The balance half of additional depreciation is allowed during the next finical year

(b) Calculation of tax liability

	u/s 172	u/s 44B
7.5% of gross receipts	1,20,000	1,20,000
(-) Expenses	-	-
Business income	1,20,000	1,20,000
(-) Business loss	-	1,20,000
PGBP	1,20,000	Nil
Other	-	-
GTI	1,20,000	Nil
(-) Deduction u/s 80 GGC	-	Nil
	1,20,000	Nil

Tax @ 41.20%	49,440	-
Tax at normal rates	-	Nil

Note: -

(i) Expenses relating to business not allowed as deduction in both cases
(ii) Brought forward business loss and deduction allowed under chapter VIA are not considered u/s 172 but are considered u/s 44B

5. (a) Computation of Salary income

	₹
Basic salary [20,000 × 4 + 30,000 × 8] =	3,20,000
Dearness pay 10,000 × 12 =	1,20,000
RPF WN (i)	Nil
Commission on turnover	80,000
Use of car (not authorized)	-
Interest free loan 2,00,000 × 18.5%	37,000
Salary income	4,77,000

Contribution to RPF

Actual contribution 15% of basic =	48,000
(-) upto 12% of salary (5,20,000 × 12%) =	62,400
	Nil

Salary = 3,20,000 + 1,20,000 + 80,000 = 5,20,000

(b) Computation of PGBP of Varma Ltd.

	₹
Net profit as per P & L A/c	30,00,000
(+) Cash credit u/s 68	30,000
(-) Bad debts u/s 36 (i) (vii)	40,000
(+) Collection from employees	80,000
(-) Amount contributed towards WF	-
(+) Provision for sales tax u/s 43B	4,00,000
(+) Depreciation on machine (not put to use)	45,000
PGBP	35,15,000

Note: -
(i) Proposed dividend not debited to P & L A/c requires no adjustment.
(ii) Amount not contributed to SWF should be disallowed.

6. (a) Computation of taxable income

		₹
Salary income of spouse u/s 64 (1) (ii)		5,00,000
Income from property u/s 64 (1) (vi)		3,00,000
Income from profession		8,00,000
LTCG u/s 10 (38)		-
Income from bonds u/s 64 (A)	50,000	
(-) AOE u/s 10 (32)	1,500	48,500
GTI		16,48,500
(-) Ded. u/s 80D (max. ₹25,000)		18,500
(-) Ded. u/s 80G (PMNRF @ 100%)		30,000
NTI		16,00,000

Tax liability

2,50,000 × 10% + 5,00,000 × 20% + 6,00,000 × 30% = ₹3,05,000

(+) Cess @ 3%	9,150
Total tax	3,14,150

(b) Computation of taxable income of a public trust

	₹
Income from property	10,00,000
Income from business	30,00,000
Voluntary contributions	5,00,000
Specific contributions	-
Total income	45,00,000
(-) General exemption @ 15%	6,75,000
	38,25,000
(-) Exemption based on application: -	
Purchase of depreciable asset	2,00,000
Amount set a part	6,25,000
Other applications	20,00,000
Interest free loans	-
Taxable income	10,00,000

7. (a) Computation of professional income

Professional Receipts :

	₹	₹
Consultancy fee (80,000 – 10,000)	70,000	
Gifts from patients	20,000	
Rent from letting operation theatre	30,000	
Profit on sale of medicines	15,000	1,35,000
Professional payments :		
Salary paid to staff	40,000	
Depreciation on motorcar [2,00,000 × 15% × 50% × 75%]	11,250	
Expenses on motor car (6,000 × 75%)	4,500	
Medical journals	2,000	57,750
Professional income		77,250

Computation of total income

PGBP	77,250
IOS (interest)	5,000
GTI	82,250
(-) Ded. u/s 80C (PPF)	12,000
TI	70,250

(b) Income computation and disclosure standards [ICDS II]

Salient features

(i) Inventories shall be valued at lost or net realizable value whichever is lower. NRV in case of dissolution of firm.

(ii) Cost of inventories shall comprise of all costs of purchase services and conversion. All costs in bringing the inventories to their present location and condition shall also be included. Trade discounts and rebates shall be deducted in determining the cost.

(iii) Cost of borrowing shall not be included unless recognized as a component of the cost specified under ICDS IX.

(iv) Cost of wasted materials, wasted labour, wasted production, storage (unless necessary in the production process).

(v) FIFO or weighted Average cost formula shall be adopted for valuation of inventories. Method shall not be changed without reasonable cause.

SECTION-B (20 Marks)

INTERNATIONAL TAXATION AND TRANSFER PRICING

II. Answer question No. 8 which is compulsory and any one from Question No. 9 and 10

8. (A) Fill in the blanks:

(a) Can

(b) Covered

(c) Deemed International Transaction

(d) Four years

(B) Select the suitable answer:

(a) (ii)

(b) (iii)

(c) (ii)

(d) (ii)

9. (a) <u>Computation of taxable profits</u>

Reasonable profit	30%	
(-) Technical support $\left[\frac{15,000 \times 100}{3,00,000}\right]$	5%	25%

$$ALP = \left[\frac{Cost \times 100}{100 - GP}\right] = \frac{18\text{ lakhs} + 12\text{ lakhs} \times 100}{75} = 40,00,000$$

(-) Total Consideration	35,00,000
Increase in profits	5,00,000

Taxable profits = Total consideration – Cost + Increase in profits.

= 35,00,000 – 30,00,000 + 5,00,000

= ₹10,00,000

(b) <u>Calculation of tax liability</u>

	₹
Income from house property (1,20,000 + 60,000) =	1,80,000
Income from business	1,80,000
Business income outside India (doubly taxed)	70,000
GTI	4,30,000

(-) Ded. u/s 80C [NSC viii]	20,000
NTI	4,10,000

Tax on NTI = 1,60,000 × 10% = 16,000

(-) Rebate u/s 87A 2,000

14,000

(+) Cess @ 3% 420

14,420

Relief u/s 91 = Doubly taxed income × ATR on TI or FIWEL

Average tax rate on total income $= \frac{14,420 \times 100}{4,10,000} = 3.517\%$

Average tax rate on foreign income $= \frac{14,025 \times 100}{70,000} = 20.04\%$

Relief u/s 91 = 70,000 × 3.517% = 2462

Tax liability = ₹14,420 – 2462 = ₹11,960 (Rounded off)

10. (a) Actual profit = ₹40,00,000

Arm's Length price $= \frac{42,00,000 + 48,00,000}{2} = 45,00,000$

Increase in profits = 45,00,000 – 40,00,000 = ₹5,00,000

Note: Since the increase exceeds safe harbor (i. e. 3%), profit disclosed by assessee should be adjusted.

(b) Arm's Length price $= \frac{58,00,000 + 64,00,000}{2}$ = ₹61,00,000

Actual profit in case of Associate enterprise = ₹60 lakhs

(no adjustment is required as it is within limits of safe harbor).

Actual profit in case of Deemed Associate enterprise = ₹59 lakhs

(adjustment is required as the variation exceeds 3%)

Reasonable profits = ₹61 lakhs.